

RETAIL INFLATION

13 August 2019

CPI moderates, room to cut rates

Retail inflation slipped to 3.1% in Jul'19 from 3.2% in Jun'19. Sharp decline in fuel and light (LPG) prices was negated by higher food and core inflation. Higher food prices were driven by pulses and spices. Within core, prices rose the most for transport & communication due to higher petrol and diesel excise duties. Education and health moderated. Outlook is benign on the back of decline in oil prices. With headline inflation expected to remain below RBI's trajectory of 4%, we believe there is room to cut rates to support growth.

Sameer Narang

Dipanwita Mazumdar | Sonal Badhan

chief.economist@bankofbaroda.com

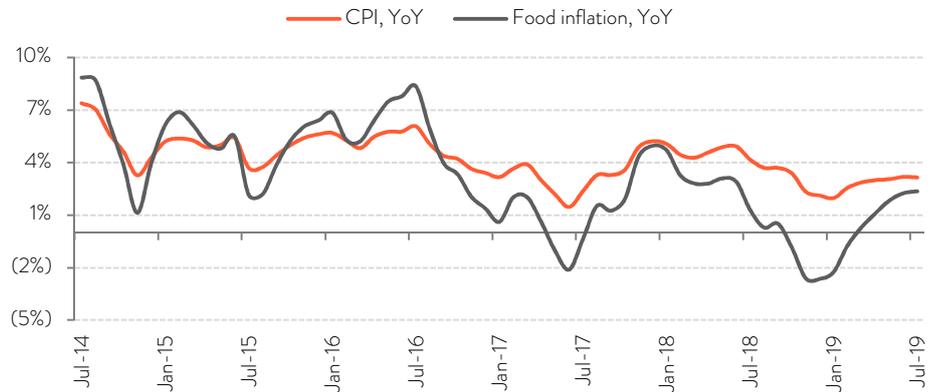
Food inflation inches up: Food inflation increased to 2.4% in Jul'19 from 2.2% in Jun'19 led by pulses at 6.8% in Jul'19 (5.7% in Jun'19), spices at 2% (1.6% in Jun'19) and milk products at 1% (0.7% in Jun'19). On the other hand, prices of fruits continue to fall, albeit at a slower pace, at (-) 0.9% in Jul'19 vs (-) 4.2% in Jun'19. Vegetable prices decelerated to 2.8% in Jul'19 from 4.7% in Jun'19. Cereal inflation remained unchanged at 1.3% in Jul'19. Moderation in international prices (Rice at -1.4% in Jul'19 vs 1.8% in Jun'19; Wheat at -7.5% vs 6.6% in Jun'19).

Core inflation rises marginally: Core inflation edged up by 20bps to 4.3% in Jul'19 vs 4.1% in Jun'19. This was led by 90bps jump in transport and communication in Jul'19 (1.6% vs 0.7% in Jun'19). This was due to increase in retail prices of petrol and diesel following increase in excise duties and cess. However, significant moderation in crude prices (-10% decline in Aug'19) implies inflation in this category will be lower. Other core inflation components (except recreation and amusement) noted broad based decline especially health (30 bps decline at 7.9%) and education (40bps decline at 6.4%).

Scope for further rate cuts: While food and core inflation did edge up in Jul'19, the decline in international oil and commodity prices along with lukewarm domestic demand implies core inflation should moderate. Food inflation is likely to increase on the back of low base. However, sufficient food grain stocks in domestic and global markets gives comfort. While recent rainfall activity has led to excess rainfall in certain areas and thus impact prices in the near-term, higher water storage will be beneficial for Rabi season. We expect headline CPI to be at 3.5% and 3.7% in FY20 and 21 respectively. This would give RBI enough headroom for another 40bps cut in FY20 to give growth the desired stimulus.

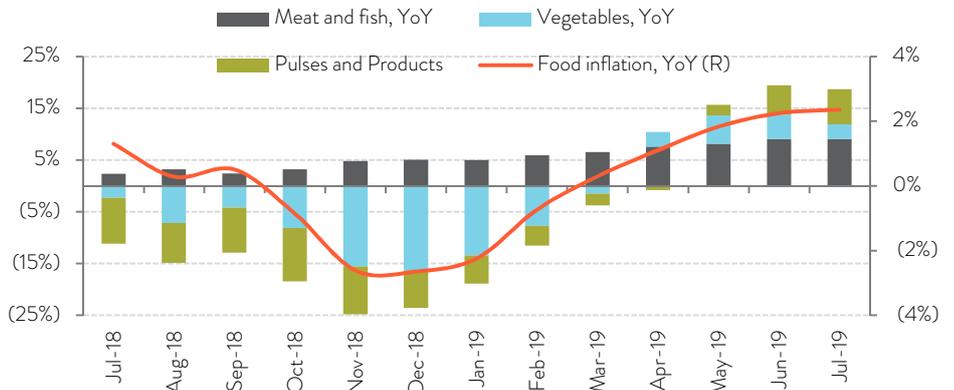


FIG 1 – CPI EDGES DOWN marginally TO 3.1% IN JUL'19 FROM 3.2% IN JUN'19



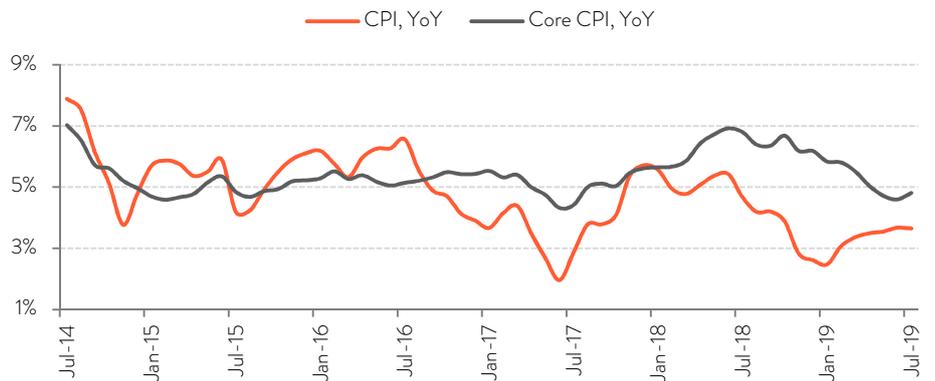
Source: CEIC, Bank of Baroda Research

FIG 2 – FOOD INFLATION INCHED UP LED BY PULSES



Source: CEIC, Bank of Baroda Research

FIG 3 – CORE INFLATION ROSE BY 20BPS TO 4.3% IN JUL'19



Source: CEIC, Bank of Baroda Research

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Economics Research Department

Bank of Baroda

chief.economist@bankofbaroda.com